

LEGAL CHANGES REQUIRED

The upgrade of the trust services provided to the Indian Tribes and individuals will not only require a modernization of the systems but a review and updating of various laws and regulations to allow the trustee (U.S. Government) more flexibility to meet the needs of the beneficiaries. In addition, the changes should be such as to facilitate the active participation of the beneficiaries, if they so desire, in managing their assets consistent with sound fiduciary principles. Subsequent paragraphs will set forth some of the changes that the Special Trustee believes necessary to accomplish these objectives.

The trustee will be governed by the prudent investor standard as adapted for the special circumstances of the trust relationship between the U.S. and Indian Tribes and individuals, which will place particular emphasis on the cultural, religious, historic or environmental significance of Indian assets held in trust. The powers and responsibilities of the trustee will be more clearly defined by adopting a modified prudent investor rule. There is a large body of case law, interpretations, law review articles and other materials that can be referenced for guidance. Also, regulatory agencies such as the Office of the Comptroller of the Currency have extensive experience and materials concerning the oversight and supervision of fiduciary activities performed under the prudent investor rule.

Generally, under the standard the trustee shall exercise reasonable care, skill and caution to make and implement investment and management decisions as a prudent investor would for the entire portfolio, taking into account the purposes and terms and provisions of the governing instrument. The governing instrument would be the applicable treaties, statutes, regulations, judgments, etc.

The prudent investor standard requires a trustee to pursue an overall investment strategy to enable the trustee to make appropriate present and future distributions to or for the benefit of the beneficiaries under the governing instrument, in accordance with risk and return objectives reasonably suited to the entire portfolio. In addition, the trustee is required to consider, to the extent relevant to the decision or action, the size of the portfolio, the nature of the fiduciary relationship, the liquidity and distribution requirements of the governing instrument, general economic conditions, the possible effect of inflation or deflation, the expected tax consequences of investment decisions or strategies and of distributions of income and principal, the role that each investment or course of action plays within the overall portfolio, the expected total return of the portfolio (including both income and appreciation of capital), and the needs of beneficiaries (to the extent reasonably known to the trustee) for present and future distributions authorized or required by the governing instrument. The prudent investor standard will allow the investment of trust funds in a wider variety of securities than now authorized under currently applicable law and regulation in order to make these funds more productive for current and future beneficiaries. It will not impact the accepted traditional use of the land except to ensure that it is preserved for future generations. However, the standard will allow the investment of trust funds in higher yielding securities appropriate for the investment of funds held in trust including investment in Tribal infrastructure and development activities subject to prudential rules.

In addition to withdrawal of trust funds under 25 CFR 1200, the Tribes will have the right to participate with the trustee in developing an investment plan for their accounts. One of the responsibilities of the trustee will be to work with the beneficiaries to ascertain their needs and determine how reasonably to accommodate them, if possible. Of course, if the liability remains with the trustee so does the final decision. However, some flexibility can be legislated to consider an investment prudent when developed under certain procedures and safeguards. For example, venture

capital investments are generally considered speculative not prudent. Nevertheless, a Tribe may determine that it can afford to risk a certain portion of its funds in a venture capital fund to promote economic development. If the trustee concurs after considering all aspects of the proposal in relationship to the Tribe's total portfolio then this would be deemed a prudent investment.

While it is important to adopt new laws, regulations, rules, policies and procedures to modernize and upgrade the trust functions and services, it is equally necessary to review existing materials and practices to eliminate, amend or revise them to conform to present day trust practices. Many of the laws dealing with the trustee's responsibilities were passed a hundred or more years ago when communications were more difficult and support services less available. In present time perhaps the trustee should not be the entity to determine whether someone is an alcoholic and if so whether to withhold disbursement of funds due that individual. There are other practices and procedures that on their face appear to be offensive and unnecessary. In any case a general review of all existing laws, regulations, rules, policies and procedures will be undertaken to conform them to modern practice. This will apply not only to the Department of the Interior, but to other departments and agencies as well. An important goal of such a review will be to identify conflicts within the government that may adversely impact the trustee's fiduciary responsibility to the beneficiaries. For example, the Treasury Department has certain interpretations of laws concerning payment of interest that impact the trust funds deposits.

Other important legal issues include probate, fractionated interest and self-governance all of which affect the trust management reform efforts to a greater or lesser extent. Many of these matters are currently under study with changes being suggested.

Finally, it should be clearly understood that the updating of the legal parameters within which trust management is performed should not be a condition for the upgrading of the financial systems. The latter is critical and will be overdue no matter when it is completed. Many of the legal and policy reforms are underway or in the planning stage. Many of these reforms will require extensive consultation and outside input. Others may require only policy guidance. In a worst case basis, if no legal reforms occur, the trust function can be adequately performed if the systems are fixed, but if all the legal and policy reforms are implemented and the systems are not fixed the situation will be worse than it is now.

1. Investment of Tribal Funds Held in Trust

Section 201 of the American Indian Trust Fund Management Reform Act of 1994 (25 U.S.C. 4021) authorizes the Secretary of the Interior to allow "Tribes an opportunity to manage tribal funds currently held in trust by the United States" in order to give Tribal governments greater control over the management of such funds or to demonstrate how the principles of self determination can work with respect to such trust funds, in a manner consistent with the trust responsibilities of the United States. At present 25 U.S.C. 161 a limits the investment of Indian Tribal funds held by the Secretary in trust to "public debt securities with maturities suitable to the needs of the funds involved." The statute restricts the type of investments that may be used and vests the selection of those investments exclusively in the hands of the Secretary. In order to accomplish the objectives of the Reform Act it will be necessary to amend 25 U.S.C. 161 a. The statute should be amended to allow the trustee to invest and reinvest funds held in trust by the United States for Indian Tribes in accordance with the prudent investor standard in any security or securities of any kind with the objective of producing a reasonable and regular return for the account consistent with the continuing needs of the beneficiaries. The trustee shall make such investments in consultation with the Indian Tribe for which the

investments are made provided the Tribe wishes to be consulted. Notwithstanding anything to the contrary, an Indian Tribe will continue to be able to withdraw some or all funds held in trust for such Tribe by the United States.

A new section of the statutes should be added which sets out the prudent investor standard applicable to the investment and management of property held in trust by the Government of the United States for both American Indians and or American Indian Tribes. That legislative language should read as follows:

PRUDENT INVESTOR ACT

(a) Prudent investor rule, purpose.

The Government of the United States, as trustee, has the duty to invest and manage property held by it in a fiduciary capacity for American Indians and American Indian Tribes in accordance with the prudent investor standard defined by this section, except as otherwise provided by the express terms and provisions of a governing instrument. This section shall apply to any investment made or held on or after January first, nineteen hundred _____ by the trustee.

(b) Prudent investor standard.

(1) The prudent investor rule requires a standard of conduct, not outcome or performance. Compliance with the prudent investor rule is determined in light of facts and circumstances prevailing at the time of the decision or action of the trustee. The trustee is not liable to a beneficiary to the extent that the trustee acted in substantial compliance with the prudent investor standard or in reasonable reliance on the express terms and provisions of the governing instrument.

(2) Trustee shall exercise reasonable care, skill and caution to make and implement investment and management decisions as a prudent investor would for the entire portfolio, taking into account the purposes and terms and provisions of the governing instrument.

(3) The prudent investor standard requires the trustee:

(A) to pursue an overall investment strategy to enable the trustee to make appropriate present and future distributions to or for the benefit of the beneficiaries under the governing instrument, in accordance with risk and return objectives reasonably suited to the entire portfolio;

(B) to consider, to the extent relevant to the decision or action, the size of the portfolio, the nature of the fiduciary relationship, the liquidity and distribution requirements of the governing instrument, general economic conditions, the possible effect of inflation or deflation, the expected tax consequences of investment decisions or strategies and of distributions of income and principal, the role that each investment or course of action plays within the overall portfolio, the expected total return of the portfolio (including both income and appreciation of capital), the cultural, religious, historic or environmental impact on Indian land and the needs of beneficiaries (to the extent reasonably known to the trustee) for present and future distributions authorized or required by the governing instrument;

(C) to diversify assets unless the trustee reasonably determines that it is in the interests of the beneficiaries not to diversify, taking into account the purposes and terms and provisions of the governing instrument; and

(D) within a reasonable time after the creation of the fiduciary relationship, to determine whether to retain or dispose of initial financial assets.

(4) The prudent investor standard authorizes the trustee:

(A) to invest in any type of investment consistent with the requirements of this paragraph, since no particular investment is inherently prudent or imprudent for purposes of the prudent investor standard;

(B) to consider related trusts, the income and resources of beneficiaries to the extent reasonably

known to the trustee, and also an asset's special relationship or value to some or all of the beneficiaries including cultural, religious, historic, environmental and similar concerns, if consistent with the trustee's duty of impartiality;

(C) to delegate investment and management functions if consistent with the duty to exercise skill, including special investment skills; and

(D) to incur costs only to the extent they are appropriate and reasonable in relation to the purposes of the governing instrument, the assets held by the trustee and the skills of the trustee.

(5) Special investment skills.

The exercise of skill contemplated by the prudent investor standard shall require the trustee to exercise such diligence in investing and managing assets as would customarily be exercised by prudent investors of discretion and intelligence having special investment skills.

(c) Delegation of investment or management functions.

(1) Delegation of an investment or management function requires the trustee to exercise care, skill and caution in:

(A) selecting a delegee suitable to exercise the delegated function, taking into account the nature and value of the assets subject to such delegation and the expertise of the delegee;

(B) establishing the scope and terms of the delegation consistent with the purposes of the governing instrument;

(C) periodically reviewing the delegee's exercise of the delegated function and compliance with the scope and terms of the delegation; and

(D) controlling the overall cost by reason of the delegation.

(2) The delegee has a duty to the trustee and to the trust to comply with the scope and terms of the delegation and to exercise the delegated function with reasonable care, skill and caution. An attempted exoneration of the delegee from liability for failure to meet such duty is contrary to public policy and void.

(3) By accepting the delegation of a trustee's function from the trustee, the delegee submits to the jurisdiction of the Federal district courts, and or any alternative dispute resolution procedure adopted by the trustee by regulation, even if a delegation agreement provides otherwise, and the delegee may be made a party to any proceeding in such courts that places in issue the decisions or actions of the delegee.

(d) Investment in securities of related investment companies.

The trustee may invest in securities of the United States Government or its agencies.

(e) As used in this section:

(1) the term "trustee" is the United States Government;

(2) the term "trust" includes any fiduciary entity with property owned by a trustee as defined in this section;

(3) the term "governing instrument" includes a court order, treaties, statutes, awards, regulations, executive orders and similar documents;

(4) the term "portfolio" includes all property of every kind and character held by a trustee as defined in this section.

Authorizing the trustee to invest Indian trust funds in securities in addition to "public debt securities" more effectively supports the trustee's fiduciary duty to serve the best interests of the beneficiaries, allow the Tribes to participate in the management of their funds held in trust in a practical and purposeful way and need not expose the trust funds to unacceptable investment risk. It is a settled principle of trusts that the trustee is under a duty to the beneficiaries to use reasonable care and skill to

make the trust property productive (See the Restatement, section 181). In making investments, however, a loss is always possible, since in any investment there is always some risk of loss even with "public debt securities." The question of the amount of risk is a question of degree.

Under accepted and established principles of trust law, it is not the duty of the trustee, either individual or corporate to invest only in the very safest and most conservative securities available. Such investments may not be in the best interests of the beneficiaries. Assuming, for example, United States government bonds are the safest and most conservative securities available but that income yield thereon is lower than other securities, it is not necessarily the duty of the trustee to invest the whole trust property, or even any part of it in such bonds. The reason for this is that by the use of care, skill and caution, an investment can ordinarily be made which will yield a higher income and as to which there is no reason to anticipate a loss of principal (See the Restatement section 227).

These theories have been tested in the market place and produced highly successful results. For example, as set out in its Annual Report for 1996, Washington Mutual Investors Fund, managed by The American Funds Group, has performed well over the forty three years since it was founded in 1952 by selecting investments suitable for trust funds. Its investment concept evolved from the experiences learned during the Depression years of the 1930's, when individuals and institutions turned away from speculative excess to re-embrace sound investment principals based on prudence, diligence and value. In 1937, the United States District Court for the District of Columbia established a "Legal List" of bonds suitable for trust funds. This List was composed of high quality issues selected by the use of a strict investment criteria which became known as "Rule 23". The court modified Rule 23 in 1947 to permit investment in an expanded Legal List which included high-grade common stocks.

With few exceptions, the investment standards established by the U.S. District Court serve as the basis for the Fund's investment choices. Some of those standards are:

- A security must be listed on the New York Stock Exchange, or be eligible and have applied for listing.
- Except for banks, a company must have:
 1. fully earned its dividends in at least four of the past five years.
 2. paid a dividend in at least nine of the past ten years.
- The ratio of current assets to current liabilities for most industrial companies must be at least 1.5 to 1, or their bonds must be rated no lower than A- or A3.
- Banks, insurance companies and other financial institutions must have capital funds of at least \$100 million.
- Banks and savings and loans must have paid a dividend in four of the past five years and
- Companies must not derive the majority of their revenues from tobacco or alcohol products.

The Fund is committed to have at least 95% of its assets invested in equity securities that meet its Eligible List criteria. Not all such securities are purchased. It is reported that there are approximately 5,300,000 companies and partnerships in the U.S.; 13,000 of these are publicly held; 2,500 are listed on the New York Stock Exchange; 290 meet the standards of the Eligible List and 133 of these were held in the portfolio in 1996.

As of April 30, 1996, the Fund's net asset value was over \$20 billion. It is reported it has out paced the Standard and Poors 500 composite Index in 32 of 34 rolling ten year periods over the past 43 fiscal years on a reinvested basis, generated positive returns in 37 of the past 43 full fiscal years, including 19 of the past 20 and held up better than S & P 500 in every stock market decline of 15% or

more since the Fund was established. In contrast, over the past several years public debt securities have made a return of six to eight percent a year, far under performing other trust appropriate investments.

The market risk of expanding the trustee's investment authority for Tribal funds can therefore, be characterized as negligible, if such authority is executed in a professional and competent manner.

2. Investment of Tribal Funds and Funds Held for Individuals in Trust.

The trustee should be authorized to invest all or a portion of Tribal funds or funds held for individuals with other Indian funds held in trust, when it is in the best interest of the beneficiary for which the funds are held in trust, in a common trust fund or funds maintained by the trustee exclusively for the collective investment and re-investment of Indian monies. Each such common trust fund shall be established and maintained in accordance with a written plan which shall be approved by the trustee and each Tribe the funds of which are to be invested in it. The plan shall contain appropriate provisions not inconsistent with the rules and regulations of the Comptroller of the Currency, 12 CFR 9, Fiduciary Powers of National Banks and Collective Investment Funds, as to the manner in which the funds are to be operated, including provisions relating to the investment powers and a general statement of the investment policy and goals of the fund; the allocation of income, profits and losses; the terms and conditions governing the admission or withdrawal of participation in the fund; the auditing of accounts of the trustee with respect to the fund; the basis and method of valuing assets in the fund, setting forth specific criteria for each type of assets; the minimum frequency for valuation of asset of the fund; the period following each valuation date during which the valuation may be made, which period in usual circumstances should not exceed ten business days; the basis upon which the fund may be terminated; and such other matters as may be necessary to define clearly the rights of participants in the fund. Except as otherwise provided at 12 CFR 9.18 (G) (15), fund assets shall be valued at market value unless such value is not readily ascertainable, in which case a fair value determined in good faith by the trustee may be used. A copy of the Plan shall be available at designated offices of the trustee for inspection during all hours the office is open for business, and upon request a copy of the Plan shall be furnished to any person.

3. Other Investments

Generally, the prudent investor rule permits a wide variety of investments in most categories of commercial and infrastructure development enterprises, provided that proper care, skill and caution are exercised by the trustee. In addition, some flexibility can be legislated to consider an investment prudent when developed under certain procedures and safeguards. For example, venture capital investments are generally considered speculative not prudent. Nevertheless, a Tribe may determine that it can afford to risk a certain portion of its funds in a venture capital investments to promote economic development. If the trustee concurs after considering all aspects of the proposal in relationship to the Tribe's total portfolio then this would be deemed a prudent investment.